Docket No. 15532

United States Court of Appeals

For the Ninth Circuit

ARTHUR L. LAWRENCE and ALMA P. LAWRENCE
Petitioners-Appellants

vs.

COMMISSIONER OF INTERNAL REVENUE
Respondent-Appellee

ON PETITION TO REVIEW A DECISION OF THE TAX COURT OF THE UNITED STATES

BRIEF FOR APPELLANTS

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OPINION BELOW

The opinion of the Tax Court in cause No. 53929 is found in the transcript (R. 35-51) and is officially reported as 27 T.C. No. 82.

JURISDICTION

Jurisdiction of this court is based on a petition for review (R. 52-53) of a decision of the Tax Court of the United States entered January 31, 1957 (R. 51), declaring a deficiency in appellants' 1948 federal income tax in the amount of $2,931.14, plus interest (R. 51). The appellants' 1948 Federal Income Tax Return was filed in the collector's office in Los Angeles, California, and the petitioners reside within the jurisdiction of the United States Court of Appeals for the Ninth Circuit. Jurisdiction of this court is invoked

pursuant to U.S.C. Title 26, §7482(a). The venue is established by U.S.C. Title 26, §7482(b)(1).[1]

QUESTIONS PRESENTED

1. Should the Commissioner be allowed to extend the statute of limitations period for assessment and collection from three years to five years by use of §275(c) of Internal Revenue Code of 1939, as amended?

2. Can the Tax Court properly refuse to follow a clear and unequivocal decision of the Court of Appeals to which the taxpayer has the right to appeal because of his residence and place of filing his federal income tax return?

STATUTES AND REGULATIONS INVOLVED

The statutes involved in this case are §275(a) and §275(c) of the Internal Revenue Code of 1939, as amended, which state as follows:

> "Sec. 275. Period of Limitation Upon Assessment and Collection.
>
> "Except as provided in section 276—
>
> "(a) General Rule.—The amount of income taxes imposed by this chapter shall be assessed within three years after the return was filed, and no proceeding in court without assessment for the collection of such taxes shall be begun after the expiration of such period.
>
> * * * *

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[1] (b) Venue.—

(1) *In general.*—Except as provided in paragraph (2), such decisions may be reviewed by the United States Court of Appeals for the circuit in which is located the office to which was made the return of the tax in respect of which the liability arises, or, if no return was made, then by the United States Court of Appeals for the District of Columbia.

"(c) Omission from Gross Income.—If the taxpayer omits from gross income an amount properly includible therein which is in excess of 25 per centum of the amount of gross income stated in the return, the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time within 5 years after the return was filed."

STATEMENT OF THE CASE

The facts in this case are stipulated (R. 16-34). There was no testimony taken before the Tax Court and the matter was submitted on written briefs without oral argument. The facts may be summarized as follows:

The appellants are husband and wife and as such they filed a joint federal income tax return for 1948 with the Collector of Internal Revenue, Los Angeles, California, on May 31, 1949, pursuant to extensions agreed to between appellants and respondent. The respondent's Notice of Deficiency was not mailed until May 10, 1954, nearly five years after the filing of the original return. The only question presented to the Tax Court by the appellants was whether the Commissioner should be allowed to extend the statute of limitations period for assessment and collection from three years to five years by use of §275(c) of Internal Revenue Code of 1939, as amended.

The respondent Commissioner assessed a deficiency on the theory that the taxpayers had improperly reported the amount of long-term capital gain received upon the distribution of assets in the liquidation of

Midway Peerless Oil Company on December 15, 1948 (R. 33-34). This asserted deficiency was then stated by the Commissioner to be a 25% omission from gross income thus extending the statute of limitations to five years so that Commissioner's assessment of tax on May 10, 1954, would be valid (R. 17, R. 33-34).

The item of income received by appellants which was in dispute for the year 1948 concerned the amount of long-term capital gain derived by appellant, Arthur L. Lawrence, upon the distribution in complete liquidation of Midway Peerless Oil Company on December 15, 1948 (R. 17). The appellant, Arthur L. Lawrence, had acquired 2,111 shares of Midway Peerless Oil Company stock on April 7, 1942, which amounted to 4.342094% of the outstanding stock (R. 17). Upon dissolution of Midway Peerless Oil Company on December 15, 1948, the appellant, Arthur L. Lawrence, received his interest in the form of a participating royalty plus other items consisting of an interest in leasehold equipment, buildings-employee cottages, and inventories, plus cash and other assets (R. 29, 33).

The taxpayer in reporting his 1948 income listed the capital gain received upon the dissolution of Midway Peerless Oil Company on Schedule D of Form 1040 (R. 27), and, in addition, on the face of Schedule D referred to an attached schedule (A) (R. 27). On Note A attached to Schedule D, the appellants itemized the total assets distributed by Midway Peerless Oil Company and reported the appraised value of the assets distributed (R. 29). On this same Note A immediately under the description of the assets distributed, the ap-

pellants explained their method of reporting the value of the lease as follows (R. 30):

> "Item 1—Lease is not readily marketable and has no ascertainable market value. Based upon the decision Agnes F. Smith, Plaintiff, v. Harry C. Westover, Defendant, 48-2, U.S.T.C. par. 9351, affirmed by the United States Court of Appeals for the Ninth Circuit, 173 Fed.2d 91 based upon the decision of the Supreme Court of the United States in *Burnet v. Logan* (X-1 CB 345), future payments will be returned as capital gains if and when received."

Immediately below the explanation concerning Item 1, the taxpayer computed the value received during 1948 by appellant, Arthur L. Lawrence. Taking the items taxpayer had received, with the exception of the lease which had been previously explained, he subtracted therefrom the basis of the stock to arrive at a realized long-term gain for calendar year 1948 (R. 30). Taxpayer then took the figures for total value received and for basis of stock and inserted these figures in the proper columns on the face of Schedule D (R. 27). Taxpayer then combined these figures with the other capital gains and losses received by the taxpayer on Schedule D, computed the amount of long-term capital gain to be taken into account on page 2 of the tax return (R. 19), and entered that amount in computing taxpayer's total receipts on page 1 of the Federal Income Tax Return (R. 18).

The figures reported by the taxpayer on Schedule D, Note A (R. 29-30), agree with the figures used by the respondent Commissioner in his Notice of Deficiency, with the exception that taxpayer listed the value of the

A. L. Lawrence distributive share of the oil lease at \$19,484.15 whereas the respondent Commissioner listed this value at \$20,104.18 (R. 33). The respondent Commissioner's assessment of deficiency was based on respondent's determination that the interest of appellant in the lease distributed to him had an ascertainable fair market value (R. 31-34).

The only issue decided by the Tax Court and here to be reviewed by this court is the applicability of §275(c) of the Internal Revenue Code of 1939, as amended, to extend the normal three-year statute of limitations to five years.

SPECIFICATION OF ERRORS

Appellants rely upon the following errors of the court below:

1. The Tax Court erred in entering judgment for the respondent Commissioner of Internal Revenue in Cause No. 53929 in that such decree is not supported by its findings of fact.

2. The Tax Court erred in deciding that on its findings of fact the proposed federal income tax deficiency against appellants for the year 1948 was not barred by §275(a) of Internal Revenue Code of 1939, as amended, for the reason that the period of limitations was not extended by §275(c) of said code.

3. The Tax Court erred in refusing to follow the previous decisions of the United States Court of Appeals for the Ninth Circuit where it was held that the extension of the statute of limitations from three to five years pursuant to §275(c) of Internal Revenue

Code of 1939, as amended, does not apply where taxpayer makes a full disclosure of income on his return and takes into account all of his gross receipts in computing his federal income tax.

4. The Tax Court erred in failing to enter a decision that there was no deficiency in federal income tax due from appellants for the calendar year 1948.

SUMMARY OF ARGUMENT

The deficiency of taxpayers for 1948 is barred by the statute of limitations, since the Notice of Deficiency was mailed more than four years from the date on which taxpayers' return was filed and the five-year period of limitations expressed in §275(c) of Internal Revenue Code of 1939, as amended, does not apply. The taxpayers made a full disclosure of all income and gross receipts received by taxpayers and a full explanation of the legal principles involved in their method of reporting. The legislative history of §275(c) shows that Congress did not intend it to apply in the case where taxpayer fully reported the gross income amounts received and used said amounts in the computations and summarizations required by the Federal Income Tax Return forms supplied by the Commissioner.

All of the appellate courts recently reviewing the situation where a taxpayer fully reports his gross income but differs from the Commissioner in the legal application of the income tax to these receipts, have held that §275(c) is not applicable. The position of the taxpayer is also supported by the most recent pro-

nouncements on the subject from the Court of Claims and by the district courts which have considered the matter.

The Tax Court should follow a controlling decision of the circuit to which the appeal of the taxpayer will lie. The Courts of Appeal reviewing Tax Court decisions which have ignored the controlling decisions of said courts have uniformly held that the Tax Court should follow the controlling decision of the appellate court to which taxpayer's appeal will lie.

ARGUMENT

I. The Facts Establish That the Taxpayer Did Not Omit from Gross Income an Amount Properly Includible Therein in Excess of 25% of the Amount of Gross Income Stated in the Return

The question involved in this case is a very simple and direct one. Did appellant *omit* from his statement of gross income contained in his return more than 25% of his gross income?

A. Burden of proof of omission is on the Commissioner.

The respondent Commissioner in this case must establish this omission because respondent Commissioner delayed in assessing the deficiency until nearly five years after the filing of appellants' return, and unless Commissioner can establish a five-year exception to the statute of limitations the assessment of deficiency is barred by §275(a) of Internal Revenue Code of 1939, as amended.

The burden of proving that the statute of limita-

tions should be extended is upon the respondent Commissioner. As stated in *C. A. Reis v. Commissioner,* 1 T.C. 9, 12, affirmed *sub silentio,* 142 F.2d 902 (6th Cir.):

> "The board has held many times in accord with general law 37 C.J. 124, that, where the respondent relies upon an exception to a statute of limitation he has the burden of proving facts to establish such exceptions. (Citations omitted.) In general, therefore, the respondent has the burden of proof of establishing an exception to the three-year limitation."

B. The taxpayers did not omit 25% of their gross receipts.

§275(c) of Internal Revenue Code of 1939, as amended, uses clear language. It is entitled "*Omission from Gross Income.*" The word "omit" is the key word in this section and is decisive of its meaning and intent. There is nothing devious, mysterious or ambiguous about the word "omit." Webster's New International Dictionary (Second Edition Unabridged—1950) defines "omit" as:

> "To leave out or unmentioned; not to insert, include, or name."

Funk & Wagnall's New "Standard" Dictionary of the English language (Standard Edition 1947) defines "omit" as:

> "To fail to include, insert, or mention; leave out, pass over; overlook; drop; as to *omit* an important fact."

This is the only meaning of the word "omit." This word has been considered many times by the court, not because of its meaning so much as its application to

various circumstances by the Commissioner. In the case of *Ewald v. Commissioner,* 141 F.2d 750, 752 (C.C.A. 6), the court defines "omit" as meaning "disregard, to fail, forbear, neglect to mention, or fail to insert or include." See also cases cited in footnote 1, page 67, of *Slaff v. Commissioner of Internal Revenue,* 220 F.2d 65 (9th Cir. 1955). In using the word "omit," Congress was not attempting to write into the statute some obscure or unknown meaning, nor was Congress attempting to merely set up some type of mathematical formula for the extending of the normal statute of limitations from three to five years. As will be pointed out hereafter, Congress was undoubtedly attempting to extend the statute of limitations to those cases where the taxpayer "failed to disclose in his return" or where a taxpayer was "so negligent as to leave out." See Preliminary Report of Subcommittee of Committee on Ways and Means, 73rd Congress, Second Session, p. 21.

It is true, as stated in the Tax Court opinion in this case, that the Tax Court has consistently applied the five-year period of limitations regardless of how honest the mistake and regardless of the possibility that somewhere in the return or papers attached to it information was given to the Commissioner concerning the transaction giving rise to the omitted income (see Tax Court Opinion, R. 40). It is equally as true that not one of the courts of appeal which have recently been called upon to review the Tax Court on this matter have supported the Tax Court. These courts have taken the position that the word "omit" as used in the statute means the taxpayer must have failed to include the

matter in the computation of his income in order for it to constitute an omission.

The appellants urge that the decision of the Tax Court is incorrect wherein it is stated that taxpayers made a computation of their income and "omitted from gross income an amount properly includible therein which is in excess of 25% of the amount of gross income stated in the return" (R. 40). When an examination is made of the appellants' 1948 Federal Income Tax Return 1040 (R. 18-30), it can readily be seen that there is no one place on the Federal Income Tax Return where a figure representing gross income can be inserted. The figure used for adjusted gross income on page 3 of the return which is used in the computation of net income, is the composite figure carried over from Item 6, page 1. This figure of adjusted gross income is composed of the total amount of wages, salaries, bonuses, commissions and other compensation and the total amount of dividends and interest, together with an adjusted amount of income from sources such as capital gains, or a business or other sources, which is computed and correlated on page 2 of the tax return (R. 18-19). Page 2 contains columns for insertion of figures from Schedules C and D, which are figures obtained as a result of computations made on those schedules. The appellants in this case, as shown by Note A and Schedule D of their return (R. 27-31), reported gross income on Schedule D in the only manner possible to report income from the type of interest that they were reporting. The Tax Court itself has recognized that there is no one place for gross income in a very similar tax case involving Schedule E of a 1945

tax return. In *Van Bergh v. Commissioner,* 18 T.C. 518, at p. 521, the court stated:

> "Curiously enough, there is no item on the Individual Income Tax Return Form expressed as indicating 'gross income.' It cannot hence be argued that the mere failure to insert the figure at any designated place in the return constitutes its omission from 'gross income.' Line 5 of the return at which point the total of the income items appears is characterized on page 3 of the return as 'Adjusted Gross Income.' A reference to §22(n), Internal Revenue Code, demonstrates that gross income and adjusted gross income are not the same."

The Tax Court, in the *Van Bergh* case, *supra,* held that a petitioner availing himself of the benefits of §107 of the Internal Revenue Code of 1939, as amended, did not omit from gross income any part of the compensation affected by entering the amounts received on Schedule E, and therefore held that the three-year statute of limitations and not the five-year statute of limitations applied.

The appellant in this case has not omitted from gross income any amounts, as shown by Schedule D and Note A of his 1948 Federal Income Tax Return (R. 27-31). The taxpayer made a full disclosure and took into account income from all sources in completing his tax return in the only manner possible without abandoning his clearly revealed legal position. As stated by this Court of Appeals in the case of *Slaff v. Commissioner,* 220 F.2d 65 (9th Cir. 1955) at page 68:

> "How such a plain statement can be construed as an omission is difficult for us to understand

under the circumstances. We feel that under the many and varied applications of §275(c) Internal Revenue Code, there were no omissions in the case at bar, and find no occasion to further torture the meaning of the word 'omit'."

II. A. Legislative History Establishes that Congress Intended the Word "Omission" to Apply to a Failure to Disclose Receipts

The provision of the statute which eventually became §275(c) originated in a subcommittee of the Ways and Means Committee of the House of Representatives of the 73d Congress. The subcommittee originally proposed that failure of taxpayers to disclose large amounts of gross income should subject such taxpayers to a complete suspension of the statute of limitations and that a change should be written into what was then §276 relating to fraud and failure to file returns stating that large omissions from gross income were to carry no period of limitation on assessment. In proposing such an additional provision, the subcommittee said in part as follows:

> "Your subcommittee is of the opinion that the limitation period on assessments should also not apply to certain cases where the taxpayer has understated his gross income on his return by a large amount, even though fraud with intent to evade tax cannot be established. It is, therefore, recommended that the statute of limitations shall not apply where the taxpayer has failed to disclose in his return an amount of gross income in excess of 25% of the amount of the gross income stated in the return. The Government should not be penalized when a taxpayer is so negligent as to leave

out items of such magnitude from his return." Preliminary Report of The Subcommittee of the Committee on Ways and Means, 73d Congress, 2d Session, p. 21. (Dec. 4, 1933)

Prior to a hearing before the full committee, the acting Secretary of the Treasury, Henry Morgenthau, Jr., issued a statement regarding the preliminary report of the subcommittee, stating at page 17:

"(27) *Understatement of gross income.* The Treasury is of the opinion that such a provision would cause considerable confusion in the closing of cases and would result in widespread uncertainty as to when a tax liability is or is not closed by the running of the statute of limitations." (Statement of the Acting Secretary of the Treasury, on Preliminary Report 73rd Cong. 2nd Session, p. 17)

The provision concerning this section was reported out of the House of Representatives as follows:

"§276(a). No return or false return: The present law permits the government to assess the tax without regard to the statute of limitations in case of failure to file a return or in case of a fraudulent return. The change in this section continues this policy, but enlarges the scope of this provision to include cases wherein the taxpayer understates gross income on his return by an amount which is in excess of 25% of the gross income stated in the return. It is not believed that taxpayers who are so negligent as to leave out of their return items of such magnitude should be accorded the privilege of pleading the bar of the statute." (House Report No. 704, accompanying H.R. 7835, 73d Congress, 2d Session, p. 35)

From the above statements, it is obvious that the House Committee and its subcommittee were attempting to extend the statute of limitations in those cases where the taxpayer failed to disclose a receipt of substantial size even though fraudulent intent could not be established.

The Treasury Department representatives and the Congressmen discussing this matter before the subcommittee clearly indicated that this provision was directed at those taxpayers who did not report their gross receipts. In testimony before the House Ways and Means Committee, the following individuals made this purpose clear (See House Hearings on Revenue Revisions before the Committee on Ways and Means, 73d Congress, 2d Session, at p. 149).

Mr. Roswell Magill of the Treasury Department stated:

> "The Subcommittee suggestion there is that in the event a taxpayer does not disclose in his return an amount in excess of 25% of the gross income which he states in his return, that there should be no Statute of Limitations upon it; and the argument is that when a taxpayer has been negligent to that extent it is fair to assess the tax against him at any time * * *
>
> "We have a recommendation which would, I believe, operate to get at the same thing in a little different way—that a taxpayer, to be required to file returns when his gross receipts are $10,000.00 or over; and with the consequence that if he does not, then he could be assessed at any time."

In the discussion with Roswell Magill, Congressman Jere Cooper of the Subcommittee said (House Hear-

ings on Revenue Revisions before the Committee on Ways and Means, 73d Congress, 2d Session, at p. 149):

> "COOPER: What we really had in mind was just this kind of a situation: Assume that a taxpayer left out, say, a million dollars; he just forgot it. We felt that whenever we found that he did that we ought to get the money on it, the tax on it.
>
> MAGILL: I will not argue against you on that score.
>
> COOPER: In other words, if a man is so negligent and so forgetful, or whatever the reason is, that he overlooks an item amounting to as much as 25% of his gross income, then we simply ought to have the opportunity of getting the tax on that amount of money."

And shortly thereafter the following occurred (House Hearings, *Supra,* p. 154):

> "CONGRESSMAN SAMUEL B. HILL:
>
> "Now this matter of the Statute of Limitations not running against an item exceeding 25% of the gross income of the taxpayer, contemplates, of course, that there has been a return made, but he simply omitted from that return a certain large part of his income?
>
> MR. MAGILL: That is true * * *."

After the bill was reported from the House, it was considered by the Senate and reported out of the Senate as follows.

> "The present law permits the government to assess the tax without regard to the statute of limitations in case of failure to file a return or in case of a fraudulent return. The House Bill continues this policy, but enlarges the scope of this provision to include cases wherein the taxpayer understates

> gross income on his return by an amount which is in excess of 25% of the gross income stated in the return. Your committee is in general accord with the policy expressed in this section of the House Bill. However, it is believed that in case of a taxpayer who makes an honest mistake, it would be unfair to keep the statute open indefinitely. For instance, a case might arise where taxpayer failed to report a dividend because he was erroneously advised by the officers of the corporation that it was paid out of capital or he might report as income for one year an item of income which properly belonged in another year. Accordingly your committee has provided for a five-year statute of limitation in such cases. This amendment also necessitates a change in §276(a) of the bill." (Senate Report No. 558 to accompany H.R. 7835, 73d Congress, 2d Session, pp. 43-44)

This matter was then referred to conference, and House of Representatives conference report No. 1385 to accompany H.R. 7835 of the 73d Congress, 2d Session, at p. 25, stated as follows:

> "Amendments Nos. 117 and 121: The House Bill provided that there should be no statute of limitations in case the taxpayer omits from gross income an amount properly includible therein which is in excess of 25% of the gross income stated in the return. Amendment No. 121 strikes out this provision and amendment No. 117 substitutes a period of limitation of five years after the filing of the return. The House recedes."

From an analysis of the above legislative history, it is clear that Congress unmistakably was limiting the scope of this section to the situation of "leaving out," "failing to mention," or "not naming." The basic test

was negligence of the taxpayer in omitting to report items of income, and there is not the slightest indication that Congress intended that the exception it was creating should apply to the situation where the taxpayer fully stated each and every item of his total income and then used the items reported to compute his net taxable income.

II. B. Section 6501(e)(1)(A) of Internal Revenue Code of 1954 Did Not Make a Change in the Law with Regard to "Omissions"

The Tax Court in its opinion (R. 41-43) states that §6501(e)(1)(A)(ii) of the Internal Revenue Code of 1954 supports the view consistently taken by the Tax Court regarding Sec. 275(c) of the Internal Revenue Code of 1939, and further states that the Ninth Circuit in *Slaff v. Commissioner,* 220 F.2d 65, 67 (9th Cir. 1955) recognized that the 1954 legislation changed the existing law. The Tax Court is incorrect in both instances in that the 1954 Revenue Code did not change the existing law nor did the Ninth Circuit so state.

A reference to the cases cited in Section III of this brief indicates that the existing law other than in the Tax Court had established that "omission" meant the failure of the taxpayer to disclose items of income in his return. The case at bar is a very good example of the reason for the passage of this section of the Internal Revenue Code of 1954. The Commissioner had consistently refused to follow the mandate of the various Courts of Appeal, the Court of Claims, and various District Courts in the plain use of the word "omit," and the Tax Court had consistently sustained the Com-

missioner's position even though faced with controlling contrary decisions in the Appellate Courts. The taxpayers had consistently prevailed in the Courts of Appeal and the Commissioner did not appeal these decisions to the Supreme Court, which meant that in each case the Commissioner could force the taxpayer to litigate through the Court of Appeals with the consequent loss of time and expense before the taxpayer could take advantage of the established law of the Circuit. It is little wonder that Congress determined that a clarifying statutory change should be made in the wording of the section to protect taxpayers from this situation.

An examination of Sec. 6501 of Internal Revenue Code of 1954 sustains the above argument. Sec. 6501 first states the general rule applying to omission from gross income in language identical to that of former §275 except for using the more commonly used "percent" in place of "per centum." The section then extends the assessment period from five years to six, and for purposes of clarifying the general rule two subparagraphs entitled (i) and (ii) are added. These subparagraphs are not added as a proviso but are solely for the purpose of clarifying the terms used in the general rule which was not changed.

In defining "omission," section (ii) defines an omission as follows:

> "In determining the amount omitted from gross income, there shall not be taken into account any amount which is omitted from gross income stated in a return if such amount is disclosed in the return, or in a statement attached to the return, in a manner adequate to apprise the Secretary or

> his delegates of the nature and amount of such item."

This court of appeals in the case of *Slaff v. Commissioner,* 220 F.2d 65 (9th Cir. 1955) did not state that this section "changed" the existing law but rather that the problem was solved for those cases arising in the future. This is indicated by the court's language on page 67 as follows:

> "The word 'omit' has been the source of much litigation. While the meaning of the word has not been in dispute, its application to various circumstances by the Commissioner has created much litigation as well as confusion over said Section 75(c), Internal Revenue Code.
>
> "Congress in the Revenue Code of 1954, 26 U.S.C.A., has solved this problem for our guidance in the future when it stated in Section 6501(e) in part as follows:" (Citation of statute omitted.)

III. All of the Courts of Appeal, the District Courts and the Court of Claims Which Have Recently Considered This Matter Have Held That §275(c) Is Not Applicable in Cases Where Taxpayer Has Made Full Disclosure of All of His Receipts in His Return

The following courts have recently considered this matter and have held that, when a taxpayer has made a full disclosure in his return of the items of his gross income and has used said items in computing his tax, there is no omission under §275(c):

Uptegrove Lumber Company v. Commissioner, 204 F.2d 570 (3rd Cir. 1953); *Deakman-Wells Company, Inc. v. Commissioner,* 213 F.2d 884 (3rd Cir. 1954); *Davis v. Hightower,* 230 F.2d 549 (5th Cir. 1956);

Goodenow v. Commissioner, 238 F.2d 20 (8th Cir. 1956); *Slaff v. Commissioner,* 220 F.2d 65 (9th Cir. 1955); *Lazarus v. U.S.,* 142 F.Supp. 897 (Ct. Cl. 1956); *Hommes v. Riddell,* 1956 P-H Fed. Tax Rep. ¶ 72, 530 (D.C. Cal.).

We rely in particular on the Court of Appeals for the Ninth Circuit clear and precise holding in *Slaff v. Commissioner,* 220 F.2d 65 (9th Cir. 1955). The taxpayer in the *Slaff* case reported his income from his employment as an agent of the American Red Cross but claimed the entire amount exempt under §168 of the Internal Revenue Code. Following its usual mathematical determination just as was done in the case at bar, the Tax Court held that the taxpayer had omitted from gross income an amount in excess of 25% of his gross income and assessment was therefore possible after the expiration of the three-year statute of limitations.

Both the Tax Court and the Court of Appeals determined that the taxpayer was wrong on the merits, so this Court of Appeals concerned itself entirely with the question of the statute of limitations.

This court phrased the question in *Slaff v. Commissioner, supra,* at page 68, as follows:

> "Shall a taxpayer who makes full disclosure on the face of his return but is passed by the Collector of Internal Revenue until the three-year statute of limitations has run, suffer a deficiency at the hands of the Commissioner because it has been overlooked?"

The court answered this question as follows:

> "We are of the view that if there are any omissions they were not on the part of the taxpayer but

of those who handled the returns after they were filed." . . .

In the case of *Uptegrove Lumber Company v. Commr.,* 204 F.2d 570 (3rd Cir. 1950), the taxpayer reported a correct statement of its gross sales. From its gross sales it then subtracted an amount designated as "the cost of goods sold." This "cost" was an aggregate of items including a reserve for retroactive wage increases pursuant to demands then pending before the National War Labor Board but later disallowed. At the time of the hearing there was no question but that the "cost of goods sold" could not lawfully include this contingent reserve fund. This error was carried forward, resulting in an incorrect gross profit from sales, and an end result of an understatement of taxable income by more than 25%. The question before the Court of Appeals for the Third Circuit as it was seen by that court, was as follows:

> "The Commissioner and the Tax Court say that the language 'omits from gross income any amount properly includible therein' should be construed broadly as if it read 'understates the final figure in his gross income computation.' The taxpayer says the words of the statute are to be taken as if they read 'omits from his computation of gross income an item or items of taxable gain.' We must decide which is the correct construction of the statute." (Page 571)

The Court of Appeals for the Third Circuit, after discussing the question further, says:

> " * * * And once the appropriateness of resort to legislative history is established, we think the history of Section 275(c) persuasively indicates

that Congress was addressing itself particularly to the situation where a taxpayer shall fail to include some receipt or accrual in his computation of gross income and not in a more general way to errors of whatever kind in that computation." (Page 572)

To substantiate this conclusion, the Appellate Court goes on to cite and discuss basically the same materials cited earlier in this brief with regard to legislative history.

The Court of Appeals for the Third Circuit concluded this section of its opinion as follows:

> " * * * In these circumstances we think it was the manifest purpose of Congress to make an exception to the three-year statute of limitations which would apply only to situations where the taxpayer had failed to make a return of some taxable gain.
>
> "And this restriction is quite logical. For there are many places throughout an income tax return where a taxpayer may make arithmetical errors or claim improper deductions with the result that his tax liability is understated. If such errors are made in good faith at any place other than the gross income section, it is clear that the government must challenge them, if at all, within the normal three-year limitation period. No reason appears or has been suggested why Congress would wish to allow a longer time to discover errors of the same type in the gross income section of the return. Yet this would be the strange result of the construction which the Commissioner would give to Section 275(c)." (Page 572)

In *Deakman-Wells Company v. Commissioner of Internal Revenue,* 213 F.2d 894 (3rd Cir. 1954) the

third circuit applied the same reasoning of the *Uptegrove* case, *supra,* to a slightly different fact situation. In the *Deakman-Wells* case the conflict was over whether the taxpayer should have reported its income on an accrual or on a cash basis, the taxpayer choosing the latter whereas he should have chosen the former. The cash method of reporting resulted in a gross profit of approximately one-half what it would be if computed on the accrual method. The taxpayer in the *Deakman-Wells* case computed his gross profit on a schedule entitled "Statement of Operations — Fiscal Year Ended April 30, 1947" which was attached to the inside portion of the return, and only the final figure appeared on Page 1 of the return.

The Commissioner attempted to distinguish the *Deakman-Wells* case from the previous *Uptegrove* case in the same Circuit because of the use of the supplemental schedule in disclosing the taxpayer's gross profit. The Court of Appeals for the Third Circuit in the *Deakman-Wells* case refused to make such a distinction, holding instead the statute did not apply merely because of an understatement of the final figure in the gross income computation and stated with regard to the method chosen by the taxpayer to disclose his income, the following:

> " * * * It can scarcely be expected that every taxpayer's business will be such that the form supplied by the Commissioner can always be followed in computing gross income. It is accordingly sufficient if all items of gross income are disclosed in a schedule attached to the return in which the computation is made." (Page 897)

In the case at bar, the taxpayers made a very complete disclosure of the total value received as a result of the distribution and complete liquidation. These figures were taken and used by the taxpayer in the income computation but were subjected to certain reductions, the same being clearly indicated as a part of the computations. This must have been readily seen when examined by the government, as shown by the fact that, with one exception, the taxpayers' figures were used by the respondent Commissioner in computing the alleged deficiency.

IV. The Tax Court Should Follow the Law of the Circuit

The Tax Court has taken the unfortunate position that it need not follow a decision of the various Circuit Courts even where the appeal in a particular case will lie to a Circuit with a clear holding in support of the taxpayer's situation (R. 43-50). The position as taken by the Tax Court leads to an inevitable result of confusion, uncertainty and lack of uniformity, with the result that the Tax Court loses the influence and respect it should have, and taxpayers such as the petitioners in this case are forced into expensive litigation over small amounts to obtain justice.

The previous opinion of this court in *Slaff v. Commissioner, supra,* is the law of this Circuit so far as the construction of Sec. 275(c) is concerned. This decision is binding upon all the courts at the trial level within this Circuit and has been followed by said courts, as may be seen with reference to the District Court decision in *Hommes v. Riddell,* 1956 P-H Fed. Tax. Rep. Par. 72,530 (D.C. Cal.).

Concerning the necessity of following the opinion of the Ninth Circuit in the *Slaff* case, *supra,* the Tax Court made the following statement:

> "If the views of the Court of Appeals for the Ninth Circuit are the same as those of the Court of Appeals for the Third Circuit there is no difficulty here, but, if it does not so distinguish this case from its *Slaff* case, then even so the Tax Court must respectfully adhere to its own views in this case." (R. 43)

The Tax Court has, on past occasions, refused to follow the opinion of a Circuit Court which has overruled a previous Tax Court decision on the same legal issues, and the Appellate Courts have properly overruled the Tax Court in this matter.

This situation faced the Tax Court in *Stacey Manufacturing Company v. Commissioner of Internal Revenue,* 24 T.C. 703, the Sixth Circuit having previously reversed the Tax Court on the same legal issue in *Owensboro Wagon Company v. Commissioner,* 209 F. 2d 617 (6th Cir. 1954). In spite of this, the Tax Court handed down the same legal conclusion that it had been reversed on in the *Owensboro Wagon* case. The 6th Circuit in *Stacey Manufacturing Co. v. Commr.,* 237 F.2d 605 (6th Cir. 1956) reversed the Tax Court and, with regard to the Tax Court's refusal to follow the previous decision of that court, said at page 606:

> "The situation developed in these cases requires the expression of our considered opinion that the Tax Court of the United States is not lawfully privileged to disregard and refuse to follow, as the settled law of the circuit, an opinion of the court of appeals for that circuit. If the tax court is not

bound on questions of law by decisions of the appropriate circuit having jurisdiction, why should any jurisdiction be vested in circuit courts of appeals to review decisions of the tax court? The district courts of the several circuits also have statutory jurisdiction in tax cases and they are bound to follow the rules of decision pronounced by the United States Court of Appeals having appellate jurisdiction over the particular district court. The tax court is no less bound to do so. The mere fact that it is a court having jurisdiction in tax cases throughout the United States does not establish the tax court as superior in any aspect to United States District Courts.

"The desire of the tax court to establish by its decisions a uniform rule does not empower it to disregard the decisions of its several reviewing courts of appeals. It is for the Supreme Court of the United States—and for that tribunal alone—to review and reverse decisions of the courts of appeals of the United States in their respective jurisdictions. Until the Supreme Court reverses a rule by a court of appeals for its circuit, that rule must be followed by the tax court."

In this connection see also *Stern v. Commr.,* 242 F.2d 322 (6th Cir. 1957).

The Seventh Circuit has also considered the position taken by the Tax Court in refusing to follow a previous opinion of that circuit. In *Sullivan v. Commissioner of Internal Revenue,* 241 F.2d 46 (7th Cir. 1957) the same legal issue had previously been decided by the Seventh Circuit, but, nevertheless, the Tax Court, following its stated policy, refused to follow that decision. The Seventh Circuit, like the Sixth Circuit, stated its disap-

proval of the position taken by the Tax Court in refusing to follow its previous decisions and said at page 47:

> " * * * If the Commissioner feels that the decision in the *Doyle* case was wrong, he should have, by application for certiorari, afforded the Supreme Court an opportunity to pass upon his contentions. Lacking such a decision by the highest court, a decision by one judge of the Tax Court, which, in effect, overrules a decision of the court of appeals in the circuit in which both cases arose, is not consonant with the responsibilities of the respective tribunals involved."

The Tax Court considers that it is necessary in the interests of uniformity that it continue to decide cases without regard to reversing opinions of the various Circuit Courts. Contrary to the above intention to create uniformity, the Tax Court's position, in fact, creates disunity. Of all the courts hearing and deciding questions concerning the legal interpretation to be applied to §275(c), only the Tax Court continues to apply the straight mathematical computation consistently used by it. The Circuit Courts have a natural tendency to coordinate and comply with the decisions of fellow Circuit Courts wherever possible. This may be seen by reference to *Goodenow v. Commissioner of Internal Revenue,* 238 F.2d 20 (8th Cir. 1956). The Tax Court in 25 T.C. 1 had held that the taxpayer omitted more than 25% from gross income because his final figure concerning capital gain on the sale of some cattle was understated by more than 25%, caused by the overstatement of a cost figure. The Eighth Circuit was of the opinion that this item was sufficiently evident from the taxpayer's return and discussed the opinions of

the Circuit Courts in *Uptegrove Lumber Company v. Commissioner, supra; Deakman-Wells Company, Inc. v. Commissioner, supra; Slaff v. Commissioner, supra; Davis v. Hightower, supra;* and then said:

> "This court has repeatedly ruled, particularly in tax cases, where uniformity of decision among the Circuits is vitally important, that the decision of a Court of Appeals of another Circuit should be followed unless demonstrably erroneous or unsound." (Page 22)

The Tax Court's refusal to follow the considered opinions of the various Circuit Courts foments litigation and causes inconvenience and oppression of taxpayers, forcing them to take the additional expense of a Circuit Court appeal even though the law of the Circuit is well established.

CONCLUSION

We submit the Tax Court's decision is erroneous in Cause No. 53929 and that the decision should be reversed with respect to the deficiency in the amount of $2,931.14, and that taxpayers should receive from respondent the sum of $4,162.22 paid by taxpayers plus 6% interest on $4,162.22 from the 1st day of March, 1957, to date, and further that appellants should be awarded their costs.

Respectfully submitted,

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